



# Commonwealth of Massachusetts State Ethics Commission

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## CONFLICT OF INTEREST OPINION EC-FD-92-1

### FACTS:

You are a candidate for public office and are required to complete and file a Statement of Financial Interests form (SFI) for the calendar year 1991. In 1991, you and your spouse, doing business through two separate realty trust entities, filed a Chapter 11 reorganization bankruptcy petition.<sup>1/</sup> That petition was later converted to a Chapter 7 liquidation petition. Together, these realty trusts contained numerous pieces of real property located in Massachusetts, and one parcel of land located in New Hampshire. In addition, two items of personal property, an automobile and a boat, were included in your bankruptcy petition. Each of these pieces of property was surrendered to the trustee in bankruptcy in June, 1991. Although you have now completed all necessary hearings in the proceedings and anticipate that a discharge will be *pro forma*, you are still awaiting a final discharge of your debts from the court. You are also, currently, the 100% owner of a corporation which, in turn, owns three time-share properties which are leased to third parties. Finally, you inform us that each of the debts held by your businesses were incurred in the ordinary course of business.

### QUESTION:

Given the above, what information are you required to report on your 1991 SFI concerning the properties which were transferred in bankruptcy and the three time-share properties?

### ANSWER:

You are required to report certain information as indicated below in response to Questions 12, 13, 15, and 16 on the SFI form.

### DISCUSSION:

#### Question 12

Question 12E requires that certain information concerning real property worth \$1,000 or more held in a trust be reported if that property was owned by the filer or an immediate family member<sup>2/</sup> as of December 31, 1991. Question 12E is based upon the requirements of G.L. c. 268B, §5(g)(2) (securities and other investments) and (6) (real property). Notwithstanding the date requirement described above, any real property located in Massachusetts which was *transferred* during the calendar year must be reported separately in Question 12G, along with the name and address of the person furnishing consideration to the reporting person or receiving it from him in respect to such transfer. *See* G.L. c. 268B, §5(g)(6). Nothing in Question 12E or Question 12G would, however, require the reporting of real property which was located outside of the Commonwealth and which was transferred during the calendar year.

Because your Chapter 11 reorganization petition was later converted to a Chapter 7 liquidation petition, we need not resolve the question of how a Chapter 11 filing would have affected you. For example, in a Chapter 11 filing, because the business entity may be reorganized, the debtor may have some, as yet unknown, future interest remaining in the property. Questions could arise as to whether a filer actually “owns” the property on December 31 for SFI filing purposes if the property was transferred to a trustee in bankruptcy during the year in a Chapter 11 filing. By contrast, a Chapter 7 liquidation filing requires that the debtor transfer his interest in the property to a trustee in bankruptcy for liquidation.<sup>3/</sup> Ordinarily, there is no expectation that the debtor will regain an interest in the property once the transfer to the trustee has been made, except for certain property which may be covered

by the debtor's right of redemption, or the rare instance where a debtor may attempt to seek a dismissal from bankruptcy.<sup>4/</sup>

We find that any interest in property which has been transferred to a trustee in bankruptcy for liquidation pursuant to Chapter 7 of the federal Bankruptcy Code automatically terminates on the date of the transfer of the interest for SFI filing purposes.<sup>5/</sup>

In the present case, your interest in the real properties in question was transferred to the trustee in bankruptcy in June, 1991 in a Chapter 7 liquidation filing. Consequently, you did not own any of the properties as of December 31, 1991. Therefore, you need not report anything in Question 12E in connection with the transferred properties because your interest in those properties terminated in June, 1991.<sup>6/</sup>

However, Question 12G would still require that you separately report the fact that each of the real properties *located in Massachusetts* was transferred to the trustee in bankruptcy during the calendar year.

You need not report anything in Question 12E (including information on the transfer) concerning the property which was located in New Hampshire. Nor need you report anything in Question 12 with respect to the boat or the automobile because those items were personal property and they were not owned by you on December 31, 1991. Finally, to the extent that you held any mortgages on the properties in question which were not discharged as of December 31, 1991, you are required to report that mortgage information in Question 12F.

### **Question 13**

Question 13A. Question 13 concerns the ownership of real property not held in a trust. Question 13A is based upon the requirements of G.L. c. 268B, §5(g)(6), and requires the reporting of similar types of information as is reported in Question 12E. Section 5(g)(6) requires that certain information concerning real property located in the Commonwealth, not held in a realty trust and worth \$1,000 or more, be reported if that property was owned by the filer or an immediate family member as of the last day of the calendar year (December 31).<sup>7/</sup> Nothing in Question 13A requires the disclosure of information concerning properties located outside the Commonwealth.

Because each of the real properties owned by you which were located in Massachusetts were transferred to a trustee in bankruptcy in June, 1991, you need not report anything in Question 13A, based upon the facts as you have described them.

On the other hand, Question 13C (similar to Question 12G, above), requires the disclosure of any properties which were *transferred* during the calendar year. Because you are required to report that same information in Question 12G (as realty trust interests), you need not report that information again in Question 13A.

Question 13B. Question 13B requires that certain information concerning investment or rental (real) property, not held in a realty trust and worth \$1,000 or more, be reported, regardless of whether the property is located in the Commonwealth or elsewhere, if such interest were owned on December 31, 1991. *See* G.L. c. 268B, §5(g)(2) and (6).

Nothing in Question 13B would require the reporting of the New Hampshire property because, even though it was likely considered an investment or rental property and, therefore, normally reportable, you did not own it on December 31, 1991 because of the Chapter 7 liquidation bankruptcy filing in June, 1991.

In addition, in 1991, you were the 100% owner of a corporation which, in turn, owned three time-share investments worth \$1,000 or more on December 31, 1991. We find that you need not report your ownership interest in the three time-shares in Question 13B because you owned those assets indirectly through your company, even though you were the sole stockholder.<sup>8/</sup>

Finally, to the extent that you held any mortgages on the properties in question which were not discharged as of December 31, 1991, you are required to report that mortgage information in Question 13D.

### **Question 15**

Question 15 requires that certain information concerning creditors to whom more than \$1,000 was owed by the filer or an immediate family member be reported if owed as of December 31, 1991. Question 15 is based upon the requirements of G.L. c. 268B, §5(g)(3). Question 15 also requires that a filer report any debt owed by a business in which she is at least a 10% owner.<sup>9/</sup>

In the present case, you state that, because of the bankruptcy filing, neither you nor your spouse owed any personal debts as of December 31, 1991. To the extent, however, that your discharge in bankruptcy was not made final as of December 31, 1991, you are advised that you will be required to report any personal debts which were in existence on that date in Question 15, if any, even if those debts were part of your bankruptcy petition for relief. Once the discharge has been received, however, you would no longer owe any personal debts which are reportable under Question 15.

In addition, you wish to know whether the debts of a company in which you were an officer or director must be reported. You need not report such debts. You are required to report only those debts which are owed by a business in which you held an equity interest of 10% or more as of December 31, 1991. *See* Instructions to SFI form (Question 15). Accordingly, you need not report any debts owed by a company in which you merely served as an officer or director.

In any event, even if you were an equity holder of 10% or more of such a business, debts which are incurred in the ordinary course of that business need not be reported regardless of the equity interest owned or the debt owed. *See* G.L. c. 268B, §5(g)(3) and Instructions to SFI form (Question 15). You have represented to this Commission that all debts held by you which are now subject to the Chapter 7 filing, were, in fact, incurred in the ordinary course of business. Based upon that representation, you need not report any such debts.<sup>10/</sup>

### **Question 16**

Question 16 requires that certain information concerning debts of \$1,000 or more which were forgiven during the calendar year be reported. Question 16 is based upon the requirements of G.L. c. 268B, §5(g)(8).

In the present case, because the bankruptcy proceedings are still technically on-going (because you have not yet received a final discharge of indebtedness), you need not report anything in Question 16. Such debts would not have been “forgiven” by December 31, 1991 and, therefore, are not reportable in Question 16. Remember, however, that it may be necessary for you to make a disclosure of the forgiveness on your 1992 SFI form if you are required to file a statement of financial interests for calendar year 1992.

**DATE AUTHORIZED:** April 13, 1992

<sup>1/</sup>*See* 11 U.S.C. §§101 *et seq.* (the federal Bankruptcy Code).

<sup>2/</sup>For purposes of G.L. c. 268B, an “immediate family member” is defined as a spouse and any dependent children residing in the reporting person’s household.

<sup>3/</sup>*See* 11 U.S.C. §704 (duties of the trustee in bankruptcy include the “collect[ion] and reduc[tion] to money the property of the estate for which such trustee serves, and [the closing] of such estate as expeditiously as is compatible with the best interests of the parties in interest”).

<sup>4/</sup>The right of redemption is found in 11 U.S.C. §722. Property entitled to redemption must be intended primarily for personal, family or household use. A dismissal from a bankruptcy petition sought by the debtor is a rare occurrence and can be made only with notice to all interested parties.

<sup>5/</sup>The trustee in bankruptcy succeeds to the debtor’s interest in his property upon the filing of the bankruptcy petition. *See, e.g., Skelton v. Clements*, 408 F.2d 353, 354 (9th Cir. 1969), *cert. denied*, 394 U.S. 933 (1969) (the trustee in bankruptcy is vested with the causes of action pending at the date of the filing of the bankruptcy petition and with the bankrupt’s personal property).

<sup>6/</sup>The conclusions expressed in this opinion would differ if you know, or have reason to know, that you would be seeking either a right of redemption as to certain personal property, or a dismissal of the bankruptcy petition, at the time of the filing of your 1991 SFI form. We understand that you have no current intention to redeem any of the property in question or to seek a dismissal of the bankruptcy petition.

<sup>7</sup>We note that Question 13A incorrectly requires that any such property be reported if held by the filer or an immediate family member at any time during the calendar year. An appropriate change to the form will be made in time for the 1992 calendar year filing requirement.

<sup>8</sup>This conclusion has no bearing, however, on issues which might arise under Questions 6 (Business Ownership/Equity) or 15 (Other Creditor Information). For example, Question 6 requires that a filer, under certain circumstances, report the ownership interest *of a business* whether held directly or through a corporation, partnership, or other Business. In the present case, the time-share holdings are not owned as a separate business interest which must be reported. Rather, they are held as an asset of a corporation which you own. Assets of a corporation are normally held only indirectly by the shareholders through stock ownership and are, therefore, generally not reportable. Assets of trusts, on the other hand, are reportable under certain conditions because the trustee normally has a direct ownership interest in those assets. *See generally EC-COI-FD-87-2.*

<sup>9</sup>The amount of debt personally owed, however, will vary in proportion to the ownership of the filer's (or immediate family member's) equity interest. For example, a 10% owner of X corporation will be considered personally liable, potentially, for 10% of the debts of the corporation while a 50% owner would report 50% of the debt.

<sup>10</sup>Debts incurred in the ordinary course of business would include, among other things, loans or debts used to finance the day-to-day operations of a business (the purchase of goods, services, or raw materials from a vendor, for example) and loans to purchase equipment or other assets used to operate a business. Such debts are, in other words, incurred on a regular basis in running the business and are incurred in the ordinary course.

On the other hand, loans or debts of a business for the purpose of financing an item or service used by a stockholder, director, officer, trustee, partner or employee of a business primarily in her personal or private capacity, or any business loan which is personally guaranteed by such persons (for the start-up of a business, for example), would not generally be deemed to have been incurred in the ordinary course of business within the meaning of §5(g).